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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1964

No. [redacted] 808

HELEN DOLMAN, LAWRENCE RUST LEE, JAMES KEITH MARSHALL, JR., E. P. R. DUVAL, and KATHERINE HANSBROUGH,
Cross-Petitioners,

vs.

PIOCHE MINES CONSOLIDATED, INC., ELY VALLEY MINES, INC., and JOHN JANNEY,
Cross-Respondents.

CROSS-PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals for the Ninth Circuit

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Subject Index

	Page
Opinions below	2
Jurisdiction	2
Questions presented	2
Rules involved	4
Statement	4
Reasons for granting the writ	9
Conclusion	14
Appendix: Federal Rules of Civil Procedure:	
23(b)	
37(d)	

Table of Authorities Cited

Cases

	Pages
Elk Fork Oil Co. v. Foster, 99 Fed. 495	10
Ferguson v. Bucks, 280 Fed. 2d 739	10
Tennessee Publ. Co. v. Carpenter, 100 Fed. 2d 728	10

Rules

Federal Rules of Civil Procedure:	
23(b)	13
37(d)	6, 10

Texts

2 Clark, Receivers, p. 1065	12

In the Supreme Court
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OCTOBER TERM, 1964

No. 643

HELEN DOLMAN, LAWRENCE RUST LEE, JAMES KEITH MARSHALL, JR., E. P. R. DUVAL, and KATHERINE HANSBROUGH,
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Cross-Petitioners* pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in

*Helen Dolman, Lawrence Rust Lee, James Keith Marshall, Jr., E. P. R. Duval and Katherine Hansbrough.

this case on May 21, 1964, from which petitions for rehearing were denied on August 3, 1964.

OPINIONS BELOW

The judgment of the United States District Court for the District of Nevada appears at R. 1238.

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 333 F.2d 257.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was made and entered on May 21, 1964, a copy of which is appended to the Petition for a Writ of Certiorari filed by the Cross-Respondent in this matter, at pages 35-37 of the appendix to that petition. The Opinion appears at pages 1-33 of the appendix to that petition. Petitions for Rehearing were denied on August 3, 1964. (Record, Vol. 24.)

The jurisdiction of this Court is invoked under 28 United States Code §1254(1).

QUESTIONS PRESENTED

1. If a court has power to enter defaults against corporate defendants because of the wilful failure of their president and dominant figure to appear for a deposition, in what has been judicially described as

a direct flaunting of the court's authority, is the entering of defaults proper even though at one point counsel stated that no such relief was being asked against the corporations?

2. If a complaint in a shareholders' derivative suit seeks injunctive relief which would bar corporate officers from taking action in connection with corporate affairs, may the court, in granting a default judgment, appoint a receiver to protect the corporate interests pending a stockholders' meeting, even though the original complaint did not specifically ask for a receivership appointment?

3. If a court, apparently acting with full authority, appoints a receiver who in good faith expends money, time and effort to carry out his duties, is it not proper to compensate that receiver for the value of his services and to reimburse him for all money which he has expended in the corporation's behalf, even though an appellate court later determines the appointment was erroneous?

4. If a corporate shareholder successfully develops litigation against the president and dominant figure of a corporation, so that the corporation receives the benefit of a one million dollar judgment against that officer, is it not proper to compensate the shareholder for the value of her services and those of her attorneys, and to reimburse her for money which she has expended in the corporation's behalf even though she was not a shareholder of record when the disputed transaction took place?

RULES INVOLVED

(These are printed in the Appendix)

Federal Rules of Civil Procedure:

23(b)

37(d)

STATEMENT

In a shareholders' derivative action on behalf of the shareholders of two mining corporations, Ely Valley Mines, Inc., and Pioche Mines Consolidated, Inc., the cross-petitioners here (plaintiffs below) charged, among other things: that John Janney (a cross-respondent here) had managed, directed and controlled all the activities of the corporations (which were made nominal defendants and which are also cross-respondents here); that the properties, assets and business of the corporations had been abandoned by the corporation, by their management and directors, and by Janney; and that for many years Janney had mismanaged corporate affairs, wasted corporate assets, and employed corporate properties for his own personal benefit and use, to the shareholders' detriment. (R. 624-25.)

The cross-petitioners prayed, among other things, that the corporations and Janney be restrained from exercising any control or entering into any transaction with regard to the corporations until further order of the federal district court. (R. 628.)

After the cross-petitioners had served notices of their intent to take Janney's deposition, expresssly as president of each of the two corporations and also in an unspecified capacity, Janney failed to appear. (T. 459, 465-68, 482-86.) His failure was characterized by the Ninth Circuit Court of Appeals as "not merely intentional; it was a direct flaunting of the authority of the court." (Opinion, p. 19.)

At this time there was pending a motion for appointment of a receiver for the two corporations. (T. 946; R. 726-744.)

Because of Janney's contumacious failure to appear, cross-petitioners moved to strike his pleadings. Counsel for cross-petitioners then stated, accurately, that no relief was prayed against the corporations and, inaccurately, that no pleadings had been filed by the corporations. (T. 409:1-3, 8-12.) In the order signed by the district court, however, the corporations' pleadings were also stricken, and defaults entered against Janney and both corporations. This discrepancy was brought to the district court's attention (T. 1179; R. 986, 1030), but the court declined to change the order, apparently because the corporations' default was technical only since they were nominal defendants against whom no relief was demanded.

Following the default by some five months, the district court appointed a receiver on March 16, 1962. (T. 969.) On the authority of this appointment and a further order of May 24, 1962, the receiver began to

carry out his duties, which included expenditures of time, effort and money, and continued to do so until the Ninth Circuit Court of Appeals vacated the appointment. (Opinion, p. 33.) Pending the final order of the district court, the receiver is still carrying out these duties to protect the interests of the corporations and the shareholders.

The Court of Appeals also reversed the order striking the pleadings of the two corporations and entering their defaults. (Opinion, p. 32.)

The basis for the Court of Appeals' action in setting aside the corporate defaults was that cross-petitioners' motion for default was not directly aimed at the corporations (Opinion, p. 20) and that the default of Janney alone did not justify a default receivership of the corporations. (Opinion, p. 24.)

While stating that the district court should not have entered the corporate defaults, the Court of Appeals acknowledged that the district court had authority to do so. Rule 37(d) of the Federal Rules of Civil Procedure granted that power. (Opinion, p. 20.)

The Court of Appeals also criticized the appointment of the receiver as erroneous for three reasons (Opinion, pp. 24-25):

1) The prayer in the complaint did not give any specific notice that a receivership would be sought, although it did ask relief to restrain the corporations and Janney from exercising any control or entering into any transaction regarding the corporations.

2) The corporations were entitled to contest the application, even though Janney was in default and

even though he was noticed for deposition at least once as a representative of the corporations.

3) Receivership is an ancillary remedy, not justified by the substantive relief sought (which asked that certain real property taxes be paid and that the corporations be awarded damages of one million dollars from Janney), even though the receiver was to be the instrument for enforcing the judgment.

In so holding, the Court of Appeals assumed that the shareholders would be able to meet, elect new boards of directors, and conduct the affairs of the corporation as they deem best (Opinion, p. 25), even though the complaint showed that for many years Janney has managed, directed and controlled all the corporate activities (R. 624-25), and the Court of Appeals has observed that Janney, the corporations and their counsel have engaged throughout the litigation "in a course of obstruction and obfuscation." (Opinion, p. 2).

As to the financial responsibility for the receivership, the Court of Appeals has ruled that the cross-petitioners, though acting in good faith, should bear all costs of the receivership that would not have arisen but for the appointment. Only those expenses that the corporations would have been forced to incur had there been no receiver, and expenses that conferred a genuine benefit on the corporations, should be charged to the corporations.

There is no showing, however, that the cross-petitioners are in a position to compensate or reimburse the receiver for carrying out his duties.

The final matter with which this cross-petition is concerned is the district court's award to cross-petitioner Helen Dolman of $46,457.90 as expenses incurred or paid by her in prosecuting the derivative action and $75,000.00 as compensation for her services. (R. 1253.) Mrs. Dolman was not a shareholder of record at the time of certain disputed transactions, having acquired her shares on and after November, 1955. (T. 1294 *et seq.*; 1396 *et seq.*) She could not, therefore, have brought this action without joining other shareholders of longer standing as co-plaintiffs, since Rule 23(b) of the Federal Rules of Civil Procedure would have barred this derivative suit. It is implied that the shareholders with standing to sue would have been unable, without Mrs. Dolman's financial help, to bring this action. (T. 553-635, 677-843, 1470-1490, 1497.)

While recognizing the complete lack of authority to support or dispute this award, the Court of Appeals reversed it on the ground that such a result "would encourage a too easy avoidance of Rule 23 (b)." (Opinion, p. 28.)

The Court of Appeals decision thus negates the effect of the District Court ruling that Mrs. Dolman investigated the affairs of the corporations, searched the corporate records for shareholders' names and addresses, and inquired about shareholders whose names and addresses were not revealed in the record. She spent many hours and days in making investigations, travelling and writing letters to procure the information on which this action is based. The facts

about the corporations and Janney leading to the million dollar judgment against Janney and in favor of the corporations were almost entirely obtained from her labors. (R. 1250.)

REASONS FOR GRANTING THE WRIT

I

The Court of Appeals for the Ninth Circuit has set aside the default of two corporations while sustaining the personal default of their president and dominant figure. By so doing, the Court of Appeals has expressed disapproval of the District Court's implied finding that the corporations' default was technical only.

As a result, if the decision of the Court of Appeals is allowed to stand, a shareholder suing in behalf of a corporation will have to declare that he is actively seeking relief against the very corporation he is trying to benefit.

The Court of Appeals has set at odds, in a real rather than nominal sense, the shareholders and the entity they wish to save, while forcing the aggrieved corporation to ally itself with the very corporate officer who is charged with wasting, mismanaging and misappropriating its assets.

To require hostility between two parties who have been victimized by the same person is to distort the shareholders' legal right to protect corporate interests. A disclaimer of relief against a corporation should

not—despite the decision of the Ninth Circuit Court of Appeals—bar the entry of what is really a nominal default by the corporation so that the shareholders may obtain recovery from a defaulting corporate representative.

The Court of Appeals acknowledged that under Rule 37(d) of the Federal Rules of Civil Procedure, the District Court had power to enter these defaults. Because this power existed, because it was wisely used by the District Court, and because shareholder derivative suits will be artificially burdened with friendly "hostile" parties if the Court of Appeals decision is allowed to stand, the United States Supreme Court should reverse the decision of the Court of Appeals and restore that of the District Court.

II

Although a District Court may appoint a receiver even on an *ex parte* application (see *Tennessee Publ. Co. v. Carpenter,* 100 Fed.2d 728, 732 (6th Cir. 1938)); the Court of Appeals has termed erroneous the District Court's appointment of a receiver here because the complaint did not seek that specific relief. In support of the appointment, see also *Elk Fork Oil Co. v. Foster,* 99 Fed. 495, 498 (4th Cir. 1900); *Ferguson v. Bucks,* 280 Fed.2d 739, 743 (3rd Cir. 1960).

The Court of Appeals has thus taken the position that a District Court can order no effective action on behalf of corporations and their shareholders when it grants relief, properly within the scope of the prayer, as follows: to restrain the corporations, as well as

their president and dominant figure, from exercising any control or entering into any transactions with regard to the corporations, until further court order.

When the District Court properly granted the prayed-for relief, but was prohibited by the Court of Appeals from implementing it to avoid harm, the corporations were endangered by the loss of all management and control over their functions. They were left without anyone effectively responsible for carrying on corporate affairs or protecting corporate interests.

Recognizing this danger, the Court of Appeals suggested that the corporate shareholders might meet, elect new boards of directors, and conduct the affairs of the corporations. Whether that suggestion is feasible or not (and a fair reading of the record indicates it is not), the arrangements suggested by the Court of Appeals take time to complete. During this period of adjustment, may the District Court properly be concerned with what happens to the interests of the corporations and their shareholders? And if the District Court, whose valid order led to this predicament, finds that the corporate and shareholder interests can best be protected by use of the court's own agent—a receiver—is this preservative action to be deemed error just because the original complaint could not foresee such an eventuality?

The United States Supreme Court should not allow its District Courts to be so unnecessarily shorn of power to preserve the status quo.

III

The District Court appointed a receiver and gave him instructions which required the expenditure of money, time and effort. The Court of Appeals decided that the appointment was erroneous, and ruled that the receiver was to be denied compensation and reimbursement from the corporations unless the corporations would have had to incur those very expenses or the expenses conferred a genuine benefit on the corporations.

For his other expenses, the receiver was allowed no claim against the corporations.

The Court of Appeals acknowledged that a leading scholar has stated that all costs of a receivership, even when erroneous, are properly charged against the corporation's funds. (See 2 Clark Receivers §637.1(m), p. 1065.)

Not only does the Court of Appeals thus come in conflict with the District Court and with Dr. Clark, but its action places all orders of a District Court under a cloud. If the Court of Appeals' ruling is allowed to stand, and compensation is largely denied to the court-appointed receiver, what persons will feel free to accept appointment by a District Court and to carry out their assigned duties in confidence?

Unless the United States Supreme Court reverses the ruling of the Court of Appeals, and grants full compensation and reimbursement to a good faith receiver, the administration of justice will be thwarted

by widespread—and valid—doubts about the power of a District Court to protect its own agents.

IV

Because the shareholders' derivative suit (which resulted in a favorable one million dollar judgment) would have been unsuccessful but for the efforts and expenditures of Mrs. Helen Dolman, a cross-petitioner here, the District Court awarded her reimbursement for her expenses in prosecuting the action, plus compensation for her services in that cause. The Court of Appeals, noting the complete lack of authority on this point, reversed the award on the ground that such a result would encourage too easy an avoidance of Fed.R.Civ. Pro.No. 23(b). (It should be noted that Mrs. Dolman had not been a shareholder of record at the time of the disputed transactions, but developed and perfected the litigation by joining appropriate shareholders as co-plaintiffs.)

What the Court of Appeals says about an easy avoidance of Rule 23(b) may be true, especially since the rule seems designed to avoid strike-suits or the buying of litigation. But the cross-petitioners urge the United States Supreme Court to pursue this judicial assumption with a more searching analysis.

It is possible (and even probable) that the denial of reimbursement or compensation to a late-appearing shareholder will successfully insulate a corporate wrongdoer from any derivative actions. To establish this contention, there need only exist a corporation

which has been so mismanaged and defrauded that the shareholders cannot sell their shares for any reasonable figure and cannot afford to bring lawsuits against the corporate officer who is cheating them. In that event—and the record in this case supports such a condition—no outsider would lend assistance to the aggrieved parties because the courts have allowed no means of repaying that outsider for his beneficial conduct.

The existence of shareholders' rights, without corresponding economic benefits, may mislead innocent parties but cannot prevent wrongdoing or bring back misappropriated assets.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

GEORGE T. DAVIS,

Counsel for Cross-Petitioners.

CERTIFICATE OF COUNSEL

I hereby certify that I am counsel for cross-petitioner in the above entitled cause and that in my judgment the foregoing cross-petition for a hearing is well founded in point of law as well as in fact and that said cross-petition is not interposed for delay.

Dated, San Francisco, California,
December 28, 1964.

GEORGE T. DAVIS,
Of Counsel for Cross-Petitioner.

(Appendix Follows)

FEDERAL RULE OF CIVIL PROCEDURE NO. 23(b)

Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

FEDERAL RULES OF CIVIL PROCEDURE, RULE 37(d)

Failure of Party to Attend or Serve Answers. If a party or an officer or managing agent of a party wilfully fails to appear before the officer who is to take his deposition, after being served with a proper notice, or fails to serve answers to interrogatories submitted under Rule 33, after proper service of such interrogatories, the court on motion and notice may

strike out all or any part of any pleading of that party, or dismiss the action or proceeding or any part thereof, or enter a judgment by default against that party.